Internal Revenue Service

memorandum

CC:TL-N-5907-88
Br2:RLOsborne

date: MAY 10 1988

to: District Counsel, Baltimore, Md. CC:BAL

from: Director, Tax Litigation Division CC:TL

subject: [redacted]

We hereby respond to your April 28, 1988, request for technical advice.

ISSUE

Is the Commissioner collaterally estopped to litigate an issue against [redacted] with respect to one set of subsidiaries, when the Commissioner previously lost on that issue in prior litigation against [redacted] with respect to another set of subsidiaries?

CONCLUSION

There is a substantial likelihood that the Commissioner will be estopped to relitigate the subject issue.

FACTS

We understand that in [redacted], [redacted] and [redacted] were merged into [redacted]. Prior to that year, [redacted] was the parent holding company for an affiliated group which included [redacted] and [redacted], and [redacted] was the parent corporation for a group which included the [redacted].

In [redacted], the Tax Court decided [redacted]. In that case the Service argued that [redacted] had improperly included [redacted] during the tax years [redacted] through [redacted]. The [redacted] that were included were amounts that had been estimated by the ICC pursuant to the Railroad Valuation Act of 1913. The court found that the taxpayer's basis treatment was proper, and ruled against the Government. Examinations is now considering whether or not to raise the same issue with respect to [redacted]. You have asked for advice as to whether the

Government will be collaterally estopped to litigate this issue against [redacted].

ANALYSIS

Under the doctrine of collateral estoppel, once an issue is determined by a court of competent jurisdiction, that determination is conclusive in subsequent suits involving different causes of action between the same parties (or persons in privity with them). The purpose of the collateral estoppel doctrine is to avoid duplicative litigation and inconsistent decisions. U.S. v. Mendoza, 464 U.S. 154 (1984). On the other hand, courts are reluctant to apply the doctrine where it will deprive a party of its right to a fair hearing. In the present circumstances, the Government had a fair hearing on the basis issue, and lost. There would seem to be no reason to permit the Government to litigate the matter again. Nonetheless, in cases where the Government is a party, courts are particularly strict in requiring both parties, not just the losing party, to be the same in the respective suits. This is usually referred to as the "mutuality" requirement. As the court in U.S. v. Mendoza, supra, stated:

> A rule allowing nonmutual collateral estoppel against the Government in such cases would thwart the development of important questions of law by freezing the first final decision rendered on a particular legal issue. Allowing only one final adjudication would deprive this Court of the benefit it receives from permitting several courts of appeals to explore a difficult question before this Court grants certiorari. (at 160)

In the present circumstances, the parties to [redacted], supra, will also be the parties to the subsequent litigation to determine the basis issue as to [redacted]. The Commissioner was the respondent in the prior suit and will be the respondent in the subsequent suit. [redacted], as the parent and agent for the consolidated group, was the petitioner in the prior suit, and will be the petitioner in the subsequent suit. However, [redacted] was not the common parent during the tax years in issue in either suit. During those years [redacted] and [redacted] were completely unrelated to each other. Accordingly, there is an issue as to whether the petitioner would be deemed substantively the same in both suits for purposes of collateral estoppel.

In analyzing mutuality, courts sometimes apply a reverse analysis. They assume that the winning party in the first suit had lost instead, and ask whether such party would be estopped in the subsequent suit. The principal consideration in answering that question is whether such party could be said to have had its

day in court. Bigelow v. Old Dominion Copper Co., 225 U.S. 111 (1912); Bruszewski v. U.S., 181 F.2d 419 (3d Cir., 1950), cert. denied, 340 U.S. 865 (1950). Applying that reverse analysis to the [redacted] matter, if [redacted] had lost in connection with [redacted]'s basis issue, assuming the [redacted] basis issue is identical, [redacted] could not argue that estoppel in the second suit would deprive it of its one chance in court. Under this analysis, [redacted] would probably be deemed the same party for purposes of collateral estoppel.

Moreover, application of estoppel would probably not deprive the Supreme Court of the benefit of permitting several courts of appeals to explore the basis issue. See Mendoza, supra. Both [redacted] matters would have been decided within the same circuit, not different circuits. Accordingly, both in form and substance the petitioners in the two suits appear to be sufficiently the same to justify application of collateral estoppel.

A second aspect of the issue arises because of the fact that the [redacted] properties and the [redacted] properties (which are the subject of the basis controversies) are different properties. In Comm'r v. Sunnen, 333 U.S. 591 (1948), the Supreme Court ruled that where the facts or transactions are separable, even though they are identical, collateral estoppel does not govern the recurring legal issue. In Montana v. U.S., 440 U.S. 147 (1978), however, the Supreme Court softened the fact requirement. There, the contracts in question were not the same in the two litigations. The Court stated, however, that only the "facts essential to the judgment" had to be the same. It ruled that estoppel was appropriate.

In the [redacted] matter, the depreciable properties of both [redacted] and [redacted] could not, of course, be literally the same properties. Nonetheless, we understand that they were all [redacted] assets. Moreover, the essential facts with respect to both sets of properties appear to be the same. The [redacted] that were included in [redacted] were in each case the amounts that were estimated by the [redacted] pursuant to the Railroad Valuation Act of 1913. We accordingly conclude that differences in actual pieces of property would probably not prevent application of collateral estoppel.

In researching this matter, we were unable to find cases directly on point. The matter is not free from doubt. However, as we have pointed out above, there are good arguments supporting estoppel in these circumstances. Moreover, the Government had unsuccessfully litigated the same basis issue against other parties even before the [redacted] decision. Southern Pacific Transportation Co. v. Commissioner, 75 T.C. 497 (1980); Southern Railway Co. v. U.S., 585 F.2d 466 (Ct. Cl. 1978). While that fact is not, strictly speaking, relevant to the [redacted] matter, it might well motivate the court to rule against the Government on estoppel grounds if the court believed the estoppel issue was

otherwise close. Accordingly, we conclude that the likelihood that estoppel will be applied in this prospective action is more than 50 percent. 1/

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1/ For a general discussion of collateral estoppel in tax cases see LITIGATION GUIDELINE MEMORANDUM CC:TL, In re Collateral Estoppel - Impact of Supreme Court Decisions in Mendoza, Stauffer, and Hooven.